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SUBJECT: COLOMBIA: 1Q06 LOOKS GOOD

¶1. Summary. Colombia's 1Q2006 GDP is expected to grow at more than 5 percent, driven by stronger domestic consumption, increased access to credit, and low inflation. During the first quarter, the Colombian peso depreciated 2 percent relative to the dollar, highlighting the importance of the GOC's debt-swap activities, which have slowed somewhat after a very active 2005. High oil prices contributed significantly to Colombia's 2005 balanced consolidated public sector budget (exceeding expectations of a 1.5 percent deficit). 2Q2006 is election season for Colombia. Regardless of the outcome of the elections, post expects budgetary reform measures will be presented to Congress when the new session begins on July 20. End Summary.

Strong Economic Growth Continues

¶2. Colombia's 1Q2006 GDP growth is estimated to be around 5.37 percent according to the National Planning Administration. Robust consumer spending benefitting from low inflation and interest rates is fueling the growth. During the first month of the year, Colombian exports grew by 21.2 percent to USD 1.6 billion, while imports grew 22.8 percent to a total of USD 1.7 billion. In first quarter trade with the U.S., Colombia enjoyed an USD 829 million surplus resulting from Colombian exports of more than USD 2.3 billion and imports of USD 1.4 billion. Colombia's energy product exports to the U.S. accounted for 70 percent of production, totaling approximately USD 623 million. Colombia's current leading import is automobiles. Oil and coal was a strong performing sector for Colombia, accounting for 56 percent of total exports because volume and price are both rising. Some experts speculate that Colombia's coal exports will surpass 9 million tons making it the 3 or 4 largest exporter. Easier access to cheaper credit is driving growth in the retail, tourism, and the construction sectors, which have been the greatest contributors to GDP growth over the last 4 quarters. The agricultural sector remains a concern, however, with negative GDP growth in output over the past three quarters.

Central Bank Maintains the Spread as the Dollar Firms

¶3. In response to the U.S. Federal Open Market Committee's decision in April to raise U.S. interest rates, the Colombian Central Bank raised Colombia's inter-banking rate by 25 basis points at the end of April. Healthy GDP growth over the past year gives the Central Bank some flexibility in interest rate policy, as inflation continues to hover at historically low levels. The Colombian peso depreciated 2 percent against the

dollar towards the end of the first quarter. The central bank attributed the devaluation, in large part, to the speculation concerning the future of the U.S. Federal Reserve's policy tightening strategy. The depreciation is causing some concern among importers, and some experts speculate that the trade figures will respond to what appears to be a market correction in the value of the peso. The domestic mortgage and consumer loan market is expanding as lenders repeatedly reduce interest rates to attract new customers.

Restructuring Foreign Debt

¶4. The Ministry of Finance's strategy to convert foreign-denominated sovereign debt into Peso-denominated sovereign obligations softened the affect of the peso's recent depreciation. With regard to sovereign debt, in 2005, the GOC capitalized on the Peso's relative strength compared to the Dollar to arrive at an external debt to internal debt (32:78) ratio that allows Colombia to have a presence in world markets without being overly exposed to exchange rate fluctuations. In 1Q2006, the pace of these conversions slowed dramatically as the Ministry of Finance swapped 250 million USD worth of short-term high-interest foreign-denominated sovereign bonds, a fraction of the 2 billion dollars worth of similar transactions completed in the 4th quarter of 2005. The conversion of foreign debt into Peso-denominated financial obligations, together with strong GDP growth, have resulted in Colombia's foreign denominated sovereign debt to GDP ratio falling from a high of 54 percent in 2002 to just above 30 percent at the end of 2005.

Foreign Reserves at 10 Year High

¶5. At the end of the first quarter, Colombia's foreign reserves totaled just over 15.1 billion USD or an average of 8 months worth of imports. In the first quarter of 2006, the central bank used a sale of USD 168 million to address exchange rate volatility. Colombia purchased 1.19 billion dollars in foreign currency for discretionary intervention purposes. Central Bank purchases started out strong in January and February but tapered out towards the end of the quarter because of the Peso's devaluation. According to the Central Bank, repatriation of savings combined with strong exports are contributing to the growth in Colombia's foreign currency reserves.

Can Colombia Keep a Balanced Budget?

¶6. In mid 1Q2006, President Uribe announced Colombia had achieved a balanced budget in 2005 as a result of strong petroleum revenues. GOC officials said Colombia is likely to achieve a balanced budget in 2006 so long as exports (namely petroleum and coal) remain strong and international commodity prices remain high. In 2006, the obligation of funds allocated in the national budget has been slower than expected as the government's ability to commit funds has been limited by the Ley de Garantias which prohibits contracting new employees or completing most government purchases until after the presidential elections. Subsequent balanced budgets are more likely if the GOC can pass meaningful territorial transfer and budgetary reform.

What Lies Ahead?

¶7. The majority of the business community beleives President Uribe will win the presidential election on May 28. Since the Uribe victory is so widely predicted, little post-election change in investment or consumption likely. If the May 28 election wre to result in a second round, many

businesspersons would probably become hesitant since Uribe's two opponents are far less business friendly. We are watching with great interest the introduction of long-awaited fiscal reform, which should be presented to Congress early in its upcoming July session. It is unclear how comprehensive the president's reform package will be, or how much of it will survive congressional debate. Tax reform, a restructuring of the territorial transfer system, and reform of the banking sector have been identified as priorities for the 2006-2007 legislative year. Delays over the verification of the FTA texts has pushed ratification of the free trade agreement well into 2007, though we expect some significant investment over the next two quarters in anticipation of the agreement's entry into force.

GDP Growth

2000	2.9
2001	1.5
2002	1.8
2003	3.9
2004	4.1
1Q05	3.93
2Q05	5.62
3Q05	5.75
4Q05	5.10
2005	5.13
1Q06	5.00(p)

Source: National Planning Department

GDP GROWTH BY SECTOR

Sector	2002	2003	2004	2005
Agriculture	0.6	3.1	2.09	2.12
Mining	4.3	12.1	2.82	3.04
Utilities	3.0	3.3	2.91	3.20
Manufacturing	1.1	4.2	4.77	3.95
Construction	12.7	12.4	10.65	12.57
Hotel/Rest.	1.4	5.1	5.62	9.21
Transport/Comm	3.0	4.5	5.05	5.08
Financial	2.4	4.6	4.33	3.53
Social Svcs	0.9	1.2	2.76	4.04
Bank Svcs		13.9	12.16	8.52
Subtotal	1.8	3.9	3.82	4.54
Taxes w/o IVA	-2.3	-1.9	5.96	13.29
GDP	1.8	3.9	3.96	5.13

Source: National Planning Department

CPI Index / Inflation

1998	16.7
1999	9.23
2000	8.75
2001	7.65
2002	6.99
2003	6.48
2004	5.50
2005	4.90
1Q06	1.91

Source: Central Bank (Banco de la Republica)

Unemployment (Percent)

1998	15.6
1999	18.1
2000	19.7
2001	13.8
2002	15.1
2003	13.1

2004	12.1
2005	10.4
Jan	13.4
Feb	13.2
Mar	11.3

Source: DANE (National Statistics Directorate)

TRADE

YEAR	IMPORTS	EXPORTS	BALANCE	(USD million)
1998	14,638	10,822	-3,816	
1999	10,659	11,596	936	
2000	11,800	12,700	900	
2001	11,996	12,329	333	
2002	11,897	11,975	78	
2003	13,022	13,127	105	
2004	15,626	16,729	1,103	
2005	21,187	19,798	1,389	

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